CHAPTER 9: POST-AWARD NEGOTIATIONS

Learning Objectives

At the end of this chapter you will be able to:

Primary Learning Objective (PLO)
Conduct a post-award negotiation (termination settlement).

Classroom Learning Objective 9/1
Describe the contract modification negotiation environment.

Classroom Learning Objective 9/2
Describe the negotiation environment of termination settlement.

Contents and Procedures

Chapter Contents

In this chapter you will learn:

9.0 Chapter Overview

Modifications and Termination Settlements

Government contract specialists must also negotiate contract modifications and termination settlements. Since the negotiation occurs after award of the initial contract, these bargaining sessions are known as post-award negotiations. In fact, many contracting offices conduct more post-award negotiations than negotiations on new contracts.

Contract modifications are changes to the terms and conditions of existing contracts. Moreover, modifications are often negotiated on contracts that have initially been awarded without negotiation, such as contracts awarded to the lowest bidder.

Termination settlements are negotiations conducted to determine what contractor costs will be reimbursed after a contract has been prematurely concluded. The two categories of termination settlements are termination for default and termination for convenience, known as "T4D" and "T4C" respectively.

Both contract modifications and termination settlements are similar to negotiating sole source contract awards, in that you will again:

- Strive for win/win outcomes utilizing the overriding negotiation themes in Chapter 1.
- Implement the negotiation process from Chapters 2 through 4 (factfinding, preparation, and negotiation).
- Apply the bargaining techniques in Chapter 5.
- Recognize bargaining tactics and, when necessary, apply countermeasures. Utilize appropriate negotiation tactics to achieve government objectives (Chapter 6).
- Apply the nonverbal communication skills in Chapter 7.

Nonetheless, there are characteristics to consider in negotiating contract modifications and termination settlements that are different from pre-award negotiations. The purpose of this chapter is to help you understand the unique bargaining environment of the two types of post-award negotiations.

9.1 Contract Modifications

Two Approaches

The government can modify contracts by either negotiating a bilateral supplemental agreement or directing a unilateral change order. A bilateral supplemental agreement occurs when there is mutual agreement between the contractor and government for the modifications When a negotiated agreement cannot be obtained or when there is not enough time to negotiate a bilateral supplemental agreement, the government can direct a unilateral change order.

Bilateral Supplemental Agreements

Negotiating bilateral supplemental agreements are similar to pre-award price negotiations with sole source contractors. Although other sources may be available to do the work, the fact that the modification must be accomplished by the contractor who was awarded the initial contract makes the bargaining atmosphere similar to that of a sole source contracting environment. Similarly, the contractor side is required to provide certified cost and pricing data when the estimated total cost of the modification is expected to exceed the applicable threshold. Like sole source awards, the basis for the negotiation is also the cost analysis.

Bargaining Environment Differences

Nevertheless, there are unique aspects to the negotiating environment that differentiate bilateral supplemental agreements from typical pre-award negotiations.

Fewer Alternatives

When negotiating supplemental agreements, the government side ordinarily has fewer alternatives because only the initial contractor can usually alter the deliverable in ways that were not agreed upon in the initial contract. Typical alternatives such as resoliciting bids to find other sources or just delaying the work are often not viable alternatives when negotiating contract modifications. This lack of alternatives often gives the contractor side more bargaining leverage during the negotiations over the bilateral supplemental agreement.

Deadlock Does Not Prevent Delivery

In contrast to increased contractor bargaining leverage, a deadlock in negotiations over a bilateral supplemental agreement will not necessarily prevent the government from obtaining the desired work from the contractor. Because of the Changes Clause in the contract, the government side has the option of issuing a unilateral change order to direct implementation of any modification within scope of that clause.

Unilateral Change Orders

A unilateral change order is a one-sided action taken by the government to legally direct the contractor to modify the contract without first obtaining a price for the change. The government can direct a unilateral change when mutual agreement on the bilateral supplemental agreement cannot be reached and deadlock occurs. Unilateral change orders are also directed when there is insufficient time to negotiate a price for the change before the modification is implemented.

The ability of the government to direct a unilateral change is unique to the world of government contracting. Because of the Changes Clause found in government contracts,[1] the contractor is legally bound to comply with the change order when the work is within the scope of the clause.

Equitable Price Adjustments

An equitable price adjustment has been legally defined as the difference between what it would have "reasonably" cost to perform the work as originally required and what it would "reasonably" cost to perform the work as changed. However, equitable price adjustments do not necessarily increase the contract price. Downward price adjustments occur when the modification directed by the unilateral change reduces expected contract costs.

The cost of a unilateral change order is determined by an equitable price adjustment. The contracting officer can either obtain mutual agreement with the contractor side on the amount of the price adjustment or unilaterally determine the amount. When agreement cannot be reached on the amount of the equitable price adjustment, the contractor has the option of litigating a claim through to the contract review boards or the courts.

Win/Win Benefits of Negotiated Agreements

A negotiated agreement on the price for the change is generally a better deal for both sides. Mutual agreements tend to be more win/win in orientation compared to either directing a change without obtaining agreement or litigating a price adjustment . Litigated price adjustments are adversarial in nature.

[1]Some other contract clauses, such as the property and termination clauses, also allow unilateral changes to the contract.

Avoid Burden of Proof

The government position is often at a significant disadvantage when the equitable price adjustment is appealed to the board of contract appeals or the courts. This disadvantage exists because the government has the legal "burden of proof" either to prove reductions in costs or to show why increased costs are unreasonable. Because of the difficulty in proving either position, the government side can often obtain a better deal in a negotiated settlement.

Avoid Cost Risk

Another reason to prefer negotiated settlements is that the government has the opportunity to negotiate fixed price terms for the new work. In contrast, litigated adjustments have the effect of converting fixed price contracts to cost reimbursable contracts for the portion of the contract that was modified. Consequently, the cost risk shifts to the government side for the work affected by the change.

When an agreement on price is not obtained, the contractor may also be able to claim actual costs that otherwise would not have been realized including:

- Indirect and direct costs of the additional work that exceed what might have been negotiated (including the costs of any delays related to the change, such as unabsorbed overhead, idle equipment, and escalation in material prices or labor rates).

- Legal fees and interest accrued on the claimed amount.

- Profit that more reflects the actual nature of work as changed. When the changed work is more difficult or riskier than the original work, boards or courts may rule that the contractor is entitled to a higher rate of profit than what was negotiated in the original contract.

Increased Costs of Uncharged Work

Besides affecting costs in the changed portion of a contract, the change may also affect the cost of the work under the initial contract that has not changed. Although the contractor is expected to work around a change as efficiently as possible, it may not always be possible to eliminate the adverse impact of the change. For example, the cost of work not changed may increase because of the need to make substantial revisions to in-plant scheduling of equipment. Likewise, there may be disruptions in the flow of work and corresponding reductions in efficiency or learning which could increase costs for the unchanged work.

Advantages to the Contractor

The contractor can also frequently obtain better deals negotiating a price for the charge instead of litigating a price adjustment. Appealing to the courts or contract review panels is a lengthy process which clouds the ultimate modification costs until the process has run its course. The contractor must often wait 4 or 5 years to receive full reimbursement for the difference between the CO's final determination and ultimate settlement. In addition, the contractor must often expend significant legal and accounting expenses to be successful.

Appealing unilateral price adjustments will generally require the contractor to legally certify the claim. Since many modifications occur on contracts that were awarded based on low bids, these contractors are not always familiar with the FAR cost principles. Having not have complied with government accounting standards, the contractor side may be understandably reluctant to sign a certification and possibly violate the False Claims Act.

9.2 Termination Settlements

Definition of Concept

Termination settlements are post-award negotiations to determine contract price when the government discontinue the contract. In a sense, termination's are like contract modifications because the original contract terms have changed. Although the government anticipated a need for a particular contract at the time of contract award, the need no longer exists or is reduced before the initial contract was expected to conclude. Contracts terminated for unsatisfactory performance are know as termination's for default (T4D). Contracts prematurely concluded for the benefit of the government are known as termination's for convenience (T4C) and will be the type of termination's we discuss in this chapter.

The purpose of this type of post-award negotiation is to determine the monetary amount paid to the contractor for the cost of the work completed up to the time of termination. Since the government wants to be fair, the intent of the settlement is to leave the terminated contractor in a position no better or worse than had the contract been completed.

Negotiation Environment

Since termination's have the effect of changing all fixed price contract types to cost reimbursable contracts, the primary focus of the negotiations is the allowability of certain costs. Even low-bid, fixed price contracts become cost reimbursable with respect to the completed portion of the work. Consequently, termination negotiations center on whether the costs are allowable, allocable, and reasonable. Although the cost principles are specified in Part 31, termination's are governed by Part 49.

FAR Part 49

Termination of "Low Bid" Contracts

Since termination settlements are frequently negotiated for contracts that were initially awarded based on low bid or catalog/market prices, the contractor side is often unaware of the reimbursable cost definitions specified by the FAR. When this occurs, the negotiations form around the costs that the government side believes are unallowable, such as interest expense.

Unallowable Costs Issue

In contrast, the contractor side often believes that the "unallowable costs" should be accepted as legitimate business expenses because of normal commercial accounting practices. The fact further strengthens their belief that the contested costs are usually legitimate income tax deductions. "Low bid" contractors sometimes perceive government unfairness in this regard because they believed at contract award that they would be reimbursed for otherwise reasonable business expenses if the contract was terminated.

Timing of Questioned Costs

Even termination settlements with contractors experienced in negotiating government contracts focus on the allowability of contract costs. However, while these contractors are usually aware of the FAR cost principles, cost validity is often disputed by the issues of "reasonableness" and "allocability." But the a major issue in the negotiations frequently is whether the questioned costs were incurred before or after the termination notice.

Government Negotiation Philosophy

The Federal Acquisition Regulation expresses the philosophy to be used as guidance in determining the termination settlement:

FAR 49.201

"A settlement should **compensate the contractor fairly** for the work done and the preparation made for the terminated portions of the contract . . . Fair compensation **is a matter of judgment and cannot be measured exactly**. In a given case, various methods may be equally appropriate for arriving at fair compensation. **The use of business judgment, as distinguished from strict accounting principles, is the heart of a settlement.**"[2]

FAR 49.113

The preceding citation expresses the government view that the contractor should be treated fairly in a win/win manner. The citation can also be interpreted to mean that the settlement should be negotiated because fairness in terms of contract price cannot be measured exactly. Part 49 the FAR also states that the cost principals specified in Part 31 are subject to the above guidance. In other words, when “fairness” clashes with the official government interpretation of costs, “fairness” should prevail.

Advantages of Negotiated Settlements

The contractor always has the option of appealing to contract review boards or the courts when negotiations deadlock and agreement cannot be reached on the settlement amount. However, like pricing contract modifications, a mutually agreed upon settlement instead of a mandated price is generally a better deal for both sides.

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[2]The citation in FAR Part 49.201 applies to terminations of fixed price contracts.

Advantages to Government

Relative to other forms of negotiations, the government generally has the least amount of bargaining pressure in negotiations over a termination settlement. Because the contract is no longer needed, deadlock does not prevent the government from acquiring a unique deliverable . Nevertheless, significant benefits are still attainable when win/win outcomes are negotiated.

Win/win outcomes should be sought in termination settlements is because the government wants to be fair to companies that do business with it. The government does not want to worsen an already difficult situation with a contractor who has already lost the business associated with the terminated portions of the contract. The government also desires good relations with the terminated contractor because of possible future business or other ongoing contracts. Moreover, the government needs win/win outcomes to maintain a good reputation in the industry to encourage other companies to vie for government contracts.

Avoid "Burden of Proof"

When termination settlements are appealed to the courts or contract review boards, the government is at a significant disadvantage. As in the case of contract modifications, the government has the legal "burden of proof" to show why costs are unreasonable or to prove questioned costs.

Advantages to Contractor

The contractor can generally obtain better deals reaching mutual agreement on the termination settlement instead of deadlocking.

Minimize Cash Flow Problem

As in the case of contract modifications, appealing to the courts or board of contract appeals will often delay final reimbursement (the difference between what is offered and the ultimate legal decision) from 4 to 5 years. Moreover, many terminated contractors are already encountering cash flow difficulties because of the lost business and cannot wait for the litigation to run its course. Cash flow problems will also be exacerbated by significant legal and accounting expenses needed to pursue a successful appeal.

Avoid Cost Certification

Litigating a termination settlement requires the contractor to certify a claim. Since many termination's occur on contracts that were awarded based on low bids or catalog/market price, many of the terminated contractors are not familiar with the FAR cost principles and may be understandably reluctant to certify costs based on government accounting standards.

Good Relations

Finally, negotiated agreements are important to the contractor because of other government contracts. Contractors do not want to harm otherwise good relations with the government by deadlocking over termination settlements. In addition, terminated contractors are often interested in future business with the government.

9.3 Summary

Summary

Post-award negotiation is an important facet of government contract negotiations and includes negotiating contract modifications and termination settlements. Although post-award negotiations are similar to negotiating sole source contract awards, there are bargaining characteristics to consider which make them different from typical pre-award negotiations.

When negotiating contract modifications, the government side generally has fewer alternatives because different contractor cannot alter the deliverable. Yet deadlock in modification negotiations may not prevent the government from obtaining the desired work. Because of the changes clause, the government side has the option of directing the modification by issuing a unilateral change order.

Terminations are like modifications because the contract terms have changed. However, in a termination the original need for the contract no longer exists. Since termination's have the effect of changing fixed price contracts to cost reimbursable contracts, the negotiations often focus on the allowability of incurred costs.

As is the case for contract modifications, deadlocked termination negotiations will not deny the government a needed deliverable. Nevertheless, there are always significant advantages for both the government and contractor to strive for win/win agreements in post award negotiations. Among other important reasons, win/win outcomes facilitate good long relations with each party that is beneficial to ongoing contracts and future business.